EX PARTE OR LATE FILED

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Boston MA 02109

OMD
Rec. 4/10/97

Mr. Andrew Fishel
Managing Director
Federal Communications Commission
1919 M Street NW, Room 852
Washington DC 20554

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APR 1 1 1997

Federal Communications Commission
Office of Secretary

April 8, 1997

EX PARTE: Access Charge Reform CC Docket 96-262
Federal State Joint Board on Universal Service CC Docket 96-45

Dear Mr. Fishel,

On February 26, 1997 a group of financial analysts, Frank Governali of Credit Suisse/First Boston, Richard Klugman of Goldman Sachs, Peter Kennedy of Morgan Stanley, Charles Shelke of Smith Barney, and I, met with Tom Boasberg, Robert Pepper, Greg Rosston, Jon Garcia, Elliot Maxwell, of the FCC staff and FCC Chairman Reed Hundt to discuss recent presentations by telecommunications companies to Wall Street analysts and investor expectations of upcoming regulatory decisions in the access charge reform and universal service dockets listed above. I have enclosed copies of the publications that the analysts issued subsequent to the meeting. In accordance with the Commission's rules, an original and two copies of this notice are being filed.

Please let me know if you have any questions.

Sincerely yours,

Anna Maria Kovacs

No. of Copies rec'd 0+2
List ABCDE

Janney Montgomery Scott

Morning Meeting Comments

FEBRUARY 27, 1997

TELECOM INDUSTRY UPDATE

ANNA-MARIA KOVACS
KRISTIN BURNS
TELECOM INDUSTRY

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In his speech, Chairman Hundt reiterated the principles of the August Interconnection Order and focused on some of the specific items that had been raised in the access Notice of Proposed Rulemaking (NPRM, 12/24/96). He stated that he considers infrastructure competition most desirable, and believes the best way to achieve that is to enable new entrants to share incumbents' facilities via resale, unbundling, and interconnection. He reaffirmed his commitment to universal service, and his belief that access reform must be done simultaneously with universal service. Specifically he stated:

While he does not believe in separate federal and state Funds, he is inclined to avoid jurisdictional litigation by focusing the federal Universal Service Fund (USF) on interstate revenues only. We believe that is likely to result in a fairly small federal USF and to be helpful to companies like Ameritech that are net contributors to the Fund, and not helpful to others like BellSouth or GTE that are large net takers from the Fund. He continues to be committed to restructuring access charges in accordance with underlying costs, converting fixed costs currently recovered on a per-minute basis to flat rates. He suggested the name FERC, flat equitable rate charge, for the flat rate. He suggested that it might be imposed more quickly or to a greater degree on second residential lines or on multibusiness lines than on first residential lines.

He asked for comment on speed of transition in moving access charges to forward looking costs, and indicated that it might make sense to move to a market-based system more rapidly on originating traffic, where the consumer has a choice about his local carrier than at the terminating end, where the consumer is at the mercy of someone else's choice. He also indicated that initial access rate cuts at the originating end might be smaller than at the terminating end.

Like the access cuts, the USF may be phased in. In considering recovery of embedded costs in this simultaneous process, he believes the profits local companies make from, wireless, publishing and long-distance should be considered as offsets to the "takings" from the core business.

He also commented with regard to Bell in-region long distance entry (section 271 entry) that he looks to the states for a record on competition in the state and that "The quality of the record compiled by each state commission may be more important than the vote that commission casts."

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On the FERC: all feel that the ability to flat-rate per minute charges would be helpful to AT&T and other IXCs as long as they could pass the charge through any way it wants. It would enable it them to lower per-minute rates, which is helpful to high-end users, and place a flat charge of small users. We also agreed that passing the FERC through the long-distance bill is likely to result in more protest from consumers than passing it through the local bill, since many consumers make little use of long distance. Our group agreed that raising the SLC would be unpopular with Congress but felt it would work better with consumers themselves.

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What we believe the FCC took away from the meeting was a sense that access cuts in the $1-3 billion range this year would be accepted calmly by the stock market, and that the FERC would be good for both local telcos and long distance carriers, but not for pure CAPs.

We continue to expect initial access cuts in the $1-2 billion range, net of universal service funding. They may well *focus* more on the terminating than originating end. We expect additional prescriptive cuts over the next several years unless the market itself takes down access rights significantly. We expect a small federal USF.

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MORGAN STANLEY
Equity Research Briefing Note

AIT, BEL, BLS, FON, GST, ICIX, ICG, IIXC, MCIC, MCLD, NYN, PAC, SBC, T, TCGI, USW, WCII, WCOM, US
Telecommunications Services (I/TEL): Meeting With the FCC

Stephanie Comfort (303) 740-6695
Peter Kennedy (212) 761-8033

Date: March 5, 1997
Type: Industry Overview

KEY POINTS

Yesterday we met with the FCC to discuss access reform and universal service. The FCC was looking for Wall Streets expectations and reactions to various outcomes.

Although the process is still fluid, we believe this meeting combined with our interpretation of Chairman Reed Hundt's recent speech to the National Association of Regulatory Utility Commissioners has given us a better sense, directionally, of where the Commission is going.

As you recall, the 1996 Telecom Act required that the Universal Fund, an explicit subsidy fund, be enhanced to support telecommunications services for low income households, high cost areas and subsidize public schools, libraries etc. Today these subsidies are primarily achieved through implicit support mechanisms (access revenues). The goal of the FCC has been to restructure the support mechanisms from implicit to explicit subsidies. This is why access reform and universal service are so intertwined.

Access Reform.

According to FCC reports, in 1995 there was $31B for in access charges paid to the local exchange providers. This consists of $7.1B in enduser revenue with the remaining $24b from switched and special access. Switched access revenues are derived from originating and terminating per minute access charges paid by the inter exchange carriers (IXCs). Today, traffic sensitive access rates are just below $0.03 per minute. These access rates have historically never been based on cost but have been used to subsidize other high cost components of the local network. The FCC intends to drive inter-state access rates down to cost over some time period.. With current estimates for forward looking economic costs coming in at $0.004-$0.01. there is a significant gap between current tariffs and cost projections.

We believe this reform will be realized through two methods, restructuring and straight reductions.

Restructuring - One of alternatives mentioned was to convert variable carrier common line (CCL) charges into fixed line charges. A portion of access rates today ($0.004-$0.02) are what are known as carrier common line charges. These charges were created to support the high cost of the local loop. Although the charges are traffic sensitive, the actual costs are not traffic sensitive and should indeed be a fixed cost. Instead of paying a per minute charge, LD providers will pay a fixed cost per pre-subscribed line.

Implications

- We believe this benefits Long Distance Providers especially those with high end customers. By placing a greater portion of variable cost into fixed costs, Interexchange providers will be able to offer price incentives to stimulate volume demand while keeping a greater portion of the costs fixed.

- For the CLECS, we believe this is slightly negative in the short term. By placing more of the revenue into fixed per line revenues, it disincents the cream skimming of high end users.

- This restructuring is slightly favorable for the RBOCs because this does disincent cream skimming but it also reduces the benefit of access volume growth in the network.

Reductions -

We also believe there will be substantial reductions in access rates driving the traffic sensitive portion down to $0.005-$0.01 range over the next three to five years. We believe that these rates will be reduced through a combination of regulatory cuts and prescribed minimums for market based reduction, with particular emphases on terminating access.

Implications

- Again this is a positive for the long distance providers to the extent retail prices remain stickier and do not decline as fast as access.

- For the CLECs this is a slight negative because of their traditional CAP business which relied heavily on access rates. The CLEC or Dial tone business is less impacted because of the diverse revenue streams of local, toll and access.

- The RBOCs should feel pressure from any significant cuts in access. It is their most profitable revenue, with 80% + margins. To the extent that the access reductions are not supplemented with Universal Service payments, these reductions will virtually all fall to the bottom line.

Universal Service Fund

The exact size of the fund has yet to be determined, but it appears to be substantially less than the present implicit fund. Currently the Commission estimates that there is $23B in access charges that are flowing to Incumbent local exchange carriers (ILECs) from IXCs. The contention that has arisen is how much of the access revenues go towards real costs and how large should the new explicit subsidy be. The ILECs believe they should be kept whole or close to whole, while the IXCs think the explicit fund should be $5-10B. We believe the Street is anticipating the fund will end up in the $10B-15B.

The FCC is currently in negotiations with the State PUCs on just how to approach the fund. Will there be two separate funds (Intra-state and Interstate) or one large universal fund? The FCC's position today, is that unless there is consensus among the States, the FCC will just run an interstate universal fund and let the States fend for themselves on the shortfalls. We believe the FCC is a bit shy after the State lawsuits over the interconnection rules but we also believe this is a bit of posturing by the FCC. The rural states with less telecommunications revenues and higher costs structures would be better off with one Federal Fund. Because of the revenue concentration in the top 10 states, we believe that the majority of States would benefit from one central fund.

Fixed Charge - With the reductions in access, the FCC has to derive another payment mechanism to support the universal fund. The mechanism that is currently being discussed is a flat rate, called the flat and equitable rate charge (FERC), based on pre-subscribed lines. The charge will probably not be equal for all lines, multi-lines and second lines will probably have premiums attached.

FCC uses Interstate Revenues to Fund the Federal Portion of Universal Funds. If the FCC goes with only Interstate revenues, no local or intrastate revenues will be affected (taxed) by the FCC Fund.

Net Impact

If the FCC remains on its present track, with the interstate fund only, we could see the ILECs' subsidy pool shrink by $5B to $10B over the next five years. This does not account for any elasticity/growth in the market or any State support mechanisms.

LD

LD players appear to be the winners in access reform. Although the timing and magnitude is still unclear, we believe that net payments to the ILECS will decline.

CLECs

We see the impact to the CLECSs as slightly negative but above expectations. The CLECs will be impacted by access reductions, but these reductions will be phased in and will be more focused on the terminating access reductions which impact the ILECs more than the CLECs. In regards to universal services contributions, if the FCC decides on an interstate fund only, CLECs will not have to contribute any revenue from its core base. Those CLECs with a large portion of LD revenues will be beneficiaries of this reform.

ILECs

Access rate reductions should eat into profitable revenues with no complete offset by universal service. RBOCs will need to rely on States for rebalancing or state run universal service funds. On the positive side, the market was eating into the high end business access and would eventually bring down rates with no rebalancing. Flat rates will ease some of the cream skimming.

Table 1
Possible Elements of Access Charge Reform and Universal Service Fund Proposal From FCC

Possible Proposal	ILEC	Implications Long Dist	CLEC
(1) Access reductions will be a combination of an upfront cut (possibly $1-$2 billion) and a mechanism to drive down access to cost over a pre-determined period of time (i.e. 3-5 yrs)	negative but better than a flash cut)	positive	negative (but better than a flash cut)
(2) As access charges are driven down, some usage based charges that the ILECs currently receive from long distance carriers will be converted to flat-rate charges.	positive	positive	negative
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Net Net	Negative	Positive	Neutral, better than scenario stocks are anticipating.

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Briefing Note

#9 AIT, BEL, BLS, FON, GST, ICIX, ICG, IXC, MCIC, MCLD, NYN, PAC, SBC, T, TCGI, USW, WCII, WCOM, US

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Restructuring - One of alternatives mentioned was to convert variable carrier common line (CCL) charges into fixed line charges. A portion of access rates today ($0.004-$0.02) are what are known as carrier common line charges. These charges were created to support the high cost of the local loop. Although the charges are traffic sensitive, the actual costs are not traffic sensitive and should indeed be a fixed cost. Instead of paying a per minute charge, LD providers will pay a fixed cost per pre-subscribed line.

Implications

- We believe this benefits Long Distance Providers especially those with high end customers. By placing a greater portion of variable cost into fixed costs, Interexchange providers will be able to offer price incentives to stimulate volume demand while keeping a greater portion of the costs fixed.

- For the CLECS, we believe this is slightly negative in the short term. By placing more of the revenue into fixed per line revenues, it disincents the cream skimming of high end users.

- This restructuring is slightly favorable for the RBOCs because this does disincent cream skimming but it also reduces the benefit of access volume growth in the network.

Reductions -

We also believe there will be substantial reductions in access rates driving the traffic sensitive portion down to $0.005-$0.01 range over the next three to five years. We believe that these rates will be reduced through a combination of regulatory cuts and prescribed minimums for market based reduction, with particular emphases on terminating access.

Implications

- Again this is a positive for the long distance providers to the extent retail prices remain stickier and do not decline as fast as access.

- For the CLECs this is a slight negative because of their traditional CAP business which relied heavily on access rates. The CLEC or Dial tone business is less impacted because of the diverse revenue streams of local, toll and access.

- The RBOCs should feel pressure from any significant cuts in access. It is their most profitable revenue, with 80% + margins. To the extent that the access reductions are not supplemented with Universal Service payments, these reductions will virtually all fall to the bottom line.

Universal Service Fund

The exact size of the fund has yet to be determined, but it appears to be substantially less than the present implicit fund. Currently the Commission estimates that there is $23B in access charges that are flowing to Incumbent local exchange carriers (ILECs) from IXCs. The contention that has arisen is how much of the access revenues go towards real costs and how large should the new explicit subsidy be. The ILECs believe they should be kept whole or close to whole, while the IXCs think the explicit fund should be $5-10B. We believe the Street is anticipating the fund will end up in the $10B-15B.

The FCC is currently in negotiations with the State PUCs on just how to approach the fund. Will there be two separate funds (Intra-state and Interstate) or one large universal fund? The FCC's position today, is that unless there is consensus among the States, the FCC will just run an interstate universal fund and let the States fund for themselves on the shortfalls. We believe the FCC is a bit shy after the State lawsuits over the interconnection rules but we also believe this is a bit of posturing by the FCC. The rural states with less telecommunications revenues and higher costs structures would be better off with one Federal Fund. Because of the revenue concentration in the top 10 states, we believe that the majority of States would benefit from one central fund.

Fixed Charge - With the reductions in access, the FCC has to derive another payment mechanism to support the universal fund. The mechanism that is currently being discussed is a flat rate, called the flat and equitable rate charge (FERC), based on pre-subscribed lines. The charge will probably not be equal for all lines, multi-lines and second lines will probably have premiums attached.

FCC uses Interstate Revenues to Fund the Federal Portion of Universal Funds. If the FCC goes with only Interstate revenues, no local or intrastate revenues will be affected (taxed) by the FCC Fund.

Net Impact

If the FCC remains on its present track, with the interstate fund only, we could see the ILECs' subsidy pool shrink by $5B to $10B over the next five years. This does not account for any elasticity/growth in the market or any State support mechanisms.

LD

LD players appear to be the winners in access reform. Although the timing and magnitude is still unclear, we believe that net payments to the ILECS will decline.

CLECs

We see the impact to the CLECSs as slightly negative but above expectations. The CLECs will be impacted by access reductions, but these reductions will be phased in and will be more focused on the terminating access reductions which impact the ILECs more than the CLECs. In regards to universal services contributions, if the FCC decides on an interstate fund only, CLECs will not have to contribute any revenues from its core base. Those CLECs with a large portion of LD revenues will be beneficiaries of this reform.

ILECs

Access rate reductions should eat into profitable revenues with no complete offset by universal service. RBOCs will need to rely on States for rebalancing or state run universal service funds. On the positive side, the market was eating into the high end business access and would eventually bring down rates with no rebalancing. Flat rates will ease some of the cream skimming.

Table 1
Possible Elements of Access Charge Reform and Universal Service Fund Proposal From FCC

Possible Proposal	Implications ILEC	Implications Long Dist	Implications CLEC
(1) Access reductions will be a combination of an upfront cut (possibly $1-$2 billion) and a mechanism to drive down access to cost over a pre-determined period of time (i.e. 3-5 yrs)	negative (but better than a flash cut)	positive	negative (but better than a flash cut)
(2) As access charges are driven down, some usage based charges that the ILECs currently receive from long distance carriers will be converted to flat-rate charges.	positive	positive	negative
(3) The terminating access charges could be driven down faster than originating access charges since there is more market pressure (or competition) on originating than on terminating access (customers don't choose who terminates their calls).	negative	positive	positive
(4) The FCC is considering running just an interstate universal service fund which would be smaller than currently expected, leaving it up to the individual states to deal with the intrastate portion of the fund.	negative	positive	positive
Net Net	Negative	Positive	Neutral, better than [illegible] stocks are anticipating.

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Date:March 10, 1997

Industry: Telecom Services

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Ratings: No Change

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- **Meeting with FCC Staffers with brief visit by Chairman Hundt.** Yesterday, February 26, we, along with four other sell-siders, met with FCC senior staffers and briefly with Chairman Reed Hundt. The avowed purpose of the meeting was to gauge the expectation of Wall Street to various policy options in the FCC arsenal regarding access reform and universal service. The FCC has been holding these meetings, and will hold others, to ensure it is adequately considering all options in its policy development, and to insure the Street is not in left field as it relates to expected outcomes. This is a smart move by the FCC, of course assuming, federal policy is not being dictated by stock prices - which of course it is not. By May 8 the FCC is required to come up with its order on access charge reform and universal service funding. The task is daunting and the implications profound for the industry. These issues get at the very heart of U.S. telecom policy and will be two of the prime determinants of whether or not competition successfully enters the local arena. (The others are the interconnect rules and the timing of RBOC entry into long distance.)

- **Hundt Lays Out Policy Principles In Presentation to NARUC On February 25.** On Tuesday Chairman Hundt presented and outline of policy priorties and principles to the National Association of Regulated Utility Commissions. It is useful to consider his points, because it was this speech that was the backdrop for our discussion with the FCC officials on Wednesday. First, Hundt reinforced the notion that access charges need to get down to forward looking costs. Second, that the recovery of costs had to be done on a basis that encouraged competition and reflected the economic incurrence of cost. Thus, he supported the joint Board recommendation to collect access on both a fixed and variable basis - a fixed monthly per line charge combined with a lower usage element. Third, he reconfirmed his position that the LECs should not be assured of fully recovering historic costs in access reform or interconnection. Fourth, he reconfirmed his commitment to a transitional implementation of reduced access charges (not a dislocating flash cut).

- **No suggestion of revenue neutral reform of access charges.** Recently there have been stories circulating that access reform will end up being a "revenue-neutral" transition for the LECs. We definitely did not hear this yesterday. There can be several interpretations of what revenue neutral means. By our definition, it means that access charges themselves are changed in such a way as to not effect the net revenue collected for access. Thus, based on our discussion yesterday, we continue to believe that access charges will be cut, producing a net reduction in revenue to the LECs on an annual basis of $5 to $7 billion by the end of a three to five year transition period. We expect the 1997 cut, and subsequent additional cuts to total $1 to $2 billion, adding up to the total $5 to $7 billion.

We have not and do not view this level of access cuts to be dramatic. This level of cuts is in line with the revenue reductions absorbed by the LEC industry in their annual price cap adjustments. This level of cuts certainly holds down revenue growth, but it in no way compromises their ability to fund capital investment and maintain the local networks, which is a key concern of regulators and politicians.

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The combined effect of the changes I'm discussing here todayis to take a significant step toward getting acess charges to cost immediately, with the bulk of additional reductions coming later, over time.

As to future access reductions, it will be critical to set in motion a predictable process in our order that will reduce access to forward looking economic cost within a reasonable time period.

...we also intend to address the question of LEC recovery of historic costs...I do not believe however, that we shol dbegin the inquiry into the historic cost issue with the supposition that the LEC is necessarily guaranteed as a matter of law a complete certainty of recovering al such investment. Takings is certainly one of our concerns here, but we must not forget "givings". Let me mention three: first, giving the LECs cellular licenses worth billions; second, giving LECs yellow pages publishing opportunities (also worth billions); and third giving LECs the opportunity to enter long distance, where they can leverage their regulated local asset.

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Industry: Telecom Services
Telephone: (207) 780-6210
Date: March 10, 1997

Industry: **Telecom Services**

Subject: **Meeting with FCC Staff & Chairman To Discuss Access Reform and Universal Service**

Ratings: **No Change**

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In terms of rate levels, we may wish to have different approaches for originating and terminating access charges. There seems to be broad consensus among economists that originating access rates will experience significantly more market pressure than terminating access.

The combined effect of the changes I'm discussing here todayis to take a significant step toward getting access charges to cost immediately, with the bulk of additional reductions coming later, over time.

As to future access reductions, it will be critical to set in motion a predictable process in our order that will reduce access to forward looking economic cost within a reasonable time period.

…we also intend to address the question of LEC recovery of historic costs…I do not believe however, that we shol dbegin the inquiry into the historic cost issue with the supposition that the LEC is necessarily guaranteed as a matter of law a complete certainty of recovering al such investment. Takings is certainly one of our concerns here, but we must not forget "givings". Let me mention three: first, giving the LECs cellular licenses worth billions; second, giving LECs yellow pages publishing opportunities (also worth billions); and third giving LECs the opportunity to enter long distance, where they can leverage their regulated local asset.

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Date: March 10, 1997

Industry: **Telecom Services**

Subject: **Meeting with FCC Staff & Chairman To Discuss Access Reform and Universal Service**

Ratings: **No Change**

Summary

On May 8 the FCC must issue its order on Access Charge Reform and Universal Service funding. The FCC wants to keep the Street's expectations in line with reality, and to insure it is aware of expectations - thus meetings have been conducted with the Street. The FCC is not telling people what it intends to do, but rather reviewing the various options. Our meeting yesterday provided no basis to change our current view on access charge and universal service reform: we continue to believe that access reform will trim annual LEC revenues by \$5 to \$7 billion (net), by the end of a 3 to 5 year transition period. Universal service fund would be \$6 to \$8 billion. Reformed access charges will be comprised of fixed per-line charge, combined with usage sensitive fee.

- **Meeting with FCC Staffers with brief visit by Chairman Hundt.** Yesterday, February 26, we, along with four other sell-siders, met with FCC senior staffers and briefly with Chairman Reed Hundt. The avowed purpose of the meeting was to gauge the expectation of Wall Street to various policy options in the FCC arsenal regarding access reform and universal service. The FCC has been holding these meetings, and will hold others, to ensure it is adequately considering all options in its policy development, and to insure the Street is not in left field as it relates to expected outcomes. This is a smart move by the FCC, of course assuming, federal policy is not being dictated by stock prices - which of course it is not. By May 8 the FCC is required to come up with its order on access charge reform and universal service funding. The task is daunting and the implications profound for the industry. These issues get at the very heart of U.S. telecom policy and will be two of the prime determinants of whether or not competition successfully enters the local arena. (The others are the interconnect rules and the timing of RBOC entry into long distance.)

- **Hundt Lays Out Policy Principles In Presentation to NARUC On February 25.** On Tuesday Chairman Hundt presented and outline of policy priorities and principles to the National Association of Regulated Utility Commissions. It is useful to consider his points, because it was this speech that was the backdrop for our discussion with the FCC officials on Wednesday. First, Hundt reinforced the notion that access charges need to get down to forward looking costs. Second, that the recovery of costs had to be done on a basis that encouraged competition and reflected the economic incurrence of cost. Thus, he supported the joint Board recommendation to collect access on both a fixed and variable basis - a fixed monthly per line charge combined with a lower usage element. Third, he reconfirmed his position that the LECs should not be assured of fully recovering historic costs in access reform or interconnection. Fourth, he reconfirmed his commitment to a transitional implementation of reduced access charges (not a dislocating flash cut).

- **No suggestion of revenue neutral reform of access charges.** Recently there have been stories circulating that access reform will end up being a "revenue-neutral" transition for the LECs. We definitely did not hear this yesterday. There can be several interpretations of what revenue neutral means. By our definition, it means that access charges themselves are changed in such a way as to not effect the net revenue collected for access. Thus, based on our discussion yesterday, we continue to believe that access charges will be cut, producing a net reduction in revenue to the LECs on an annual basis of \$5 to \$7 billion by the end of a three to five year transition period. We expect the 1997 cut, and subsequent additional cuts to total \$1 to \$2 billion, adding up to the total \$5 to \$7 billion.